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MICHAEL RODAK, JR., CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1976

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No. 76-222
—

ESTATE OF ALVIN THALHEIMER, RUTH B. ROSENBERG,
SURVIVING EXECUTRIX, ET AL., *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

—
On Petition for a Writ of Certiorari to the United States
Court of Appeals for the Fourth Circuit
—

REPLY BRIEF FOR THE PETITIONERS
—

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ARGUMENT

1. The government misstates the nature of the questions presented for review. These are not factual questions. As this Court has stated before in reversing improper valuation decisions, "the question of what criterion should be employed for determining . . . 'value' . . . is a question of law." *Powers v. Commissioner*, 312 U.S. 259, 260 (1941).

The government employs words and phrases in an artfully ambiguous fashion and misconstrues the decisions below in an effort to imply that these decisions are consistent with the decision of the Third Circuit Court of Appeals in *Laird v. Commissioner*, 85 F.2d 598, 600 (3d Cir. 1936). Thus, the government claims that "the discounts the Tax Court applied to reflect the minority status of the decedents' shareholdings and the absence of a ready market closely approximate" the discounts used in the *Laird* case on remand and that the Third Circuit Court's decision in *Laird* is "not . . . contrary" to the decisions below. (Gov. Br. p. 5)¹ It is true that in *Laird* on remand, as in the instant cases, discounts for the factors of minority status in and lack of ready market for the stock in the closely-held corporation were applied. However, the government's description of *Laird* on remand fails to mention that additional discounts were also granted in that case to take account of the capital gains taxes and blockage which affected the value of underlying assets. These additional discounts were granted in *Laird* pursuant to the Third Circuit Court's mandate that "all factors" bearing on value must be given effect including blockage and other factors reducing the value of corporate assets, and that corporate assets consisting of large blocks of stock in other corporations could not be valued by simply multiplying the number of shares held by stock market prices.² The

¹ "Gov. Br." refers to the government's Brief in Opposition to the Petition for a Writ of Certiorari.

² The Third Circuit Court stated: "In valuing the shares of stock owned by these family corporations, the respondent [Commissioner] used the median between the high and low points at which these shares sold on the date of death of the decedent' . . . This . . . directly violated [the] . . . regulations. . . . The stock

decisions by the courts below, that discounts for blockage and other factors reducing the value of corporate assets could not be granted as a matter of law, and that the stocks of Standard Oil of Indiana and other corporations held by Atapeco *had* to be valued by multiplying the number of shares held by Atapeco by the stock market prices, created a direct conflict with the Third Circuit Court.

The government misleadingly implies that the factors depressing the value of Atapeco's underlying assets were somewhere taken into account by the courts below. Thus, the government declares that the Tax Court adopted a technique "to reflect the various factors affecting marketability" (Gov. Br. p. 5). Further, "as long as the ultimate determination of value . . . was properly discounted . . . it is irrelevant whether the preliminary valuation of the Atapeco assets also satisfied that test." (Gov. Br., p. 5.) The implication of these statements, that the restrictions which reduced the market value of Atapeco's assets were taken into account somewhere down the line by the Tax Court, is altogether incorrect. The *only* discounts the Tax Court considered were discounts for the lack of marketability of *minority interests* in the closely-held company itself. No account was taken anywhere of the factors which plainly reduce the value of Atapeco's assets.

in these two close corporations could not have been sold on the day of Mr. Laird's death Even if it could have been done . . . it would have driven the price of the duPont stock [held by the two corporations] down. . . . [T]he Commissioner . . . [may not] take the mean between the highest and the lowest selling prices of a comparatively small number of the shares of the stock which constitutes the . . . asset of the corporation, apply this price to the shares of stock, and thus find their speculative value and assess accordingly." 85 F.2d at 601.

The Tax Court's opinion, which the Fourth Circuit Court affirmed, states flatly:

"[P]etitioners' expert applied discounts to various assets for such factors as blockage, distribution expenses, investment restrictions, and/or capital gains tax. The record clearly shows that Atapeo is a diverse, viable going concern, and there is no evidence of a plan for its liquidation, voluntary or otherwise. Under these circumstances, the discounts applied by petitioners' expert . . . were inappropriate and improper [citations omitted]." App. A, 67a.

It was only after the Tax Court had so unequivocally noted that no consideration could be given to factors affecting the value of Atapeo's assets that it proceeded to consider the discounts to be applied because of lack of marketability of minority interests.

The government asserts that the decisions below are "not . . . contrary" to *Laird* because "the Tax Court considered the preliminary discounts urged by petitioners but properly concluded that they were not justified because Atapeo did not contemplate liquidation or sale of its assets." (Gov. Br. pp. 5-6). This assertion of consistency with *Laird* is utterly misleading. In *Laird*, there was no evidence or indication whatever of impending liquidation, yet the factors which the courts below regarded as legally "improper" to be recognized were *compelled* by the Third Circuit Court of Appeals to be not only considered but also given effect. Failure to grant discounts for these factors resulted in reversal in *Laird*.

The government does not contend that willing buyers and sellers would not consider the blockage, restric-

tions on sale, and trapped capital gains taxes which affect Atapeo's assets, in valuing Atapeo stock.³ Rather, the government asserts (Gov. Br., p. 5) that the willing buyer-willing seller test of value is somehow inapplicable because the parties and the courts below agreed to value Atapeo shares by a two-step process, first determining the asset value of Atapeo's stockholdings in other companies and then applying discounts for minority status and the lack of a ready market for the closely-held stock. The Regulations require that *all factors* which would affect a willing buyer and seller in setting a price be considered in valuing a decedent's stock. Treas. Regs. Sec. 20.2031-1(b). It is irrelevant whether such factors are considered at the stage of determining the asset value of the stock, or at some other stage in the valuation process. However, such factors must be considered at some point. The courts below held, in direct conflict with the Third Circuit Court's decision in *Laird*, that as a matter of law they could *not* consider or give effect to the blockage, restrictions on sale, and capital gains taxes which devalued Atapeo's assets, at any point in the valuation process.

2. The government asserts that the Tax Court made a valid finding of a "thin" market for Crown stock and sought a "more accurate guide" than market prices in valuing Atapeo's Crown shares. (Gov. Br., p. 7.) The record is totally devoid of evidence even

³ The SEC has expressly recognized that such factors *are* considered by willing buyers and sellers in setting market prices. See Pet. Cert. pp. 11-12.

suggesting "thinness."⁴ (Pet. Br. below, pp. 37-39).⁵ The Third Circuit case of *Amerada Hess Corp. v. Commissioner*, 517 F.2d 75 (3d Cir. 1975), *cert. denied*, 423 U.S. 869 (1975) requires that market prices which do not accurately reflect value are to be adapted by reference to specific adjusting factors. The Third Circuit has already repudiated valuations made without regard to the specific standards set forth in the regulations. (See Pet. Cert., pp. 14-15.) A reliance on book value, more than doubling the value established by substantial market trading, is arbitrary and reflects the use of an improper criterion in making the valuation.

⁴ The percentage trading volume of Crown stock was *greater* than that of stocks for which the Tax Court did use market prices in its valuation determination. The government asserts that market prices for "comparable" oil companies were utilized by the Tax Court in its value determination. (Gov. Br., p. 7.) Nothing in the record shows that the companies utilized were in any way comparable to Crown, or were experiencing any of Crown's difficulties. The mere fact that one company operates in the same industry as another does not make the two companies "comparable" for valuation purposes. See *Estate of D. J. Levenson v. Commissioner*, 282 F.2d 581 (3d Cir. 1960); *Russell v. United States*, 260 F. Supp. 493 (N.D. Ill. 1966); Rev. Rul. 59-60, Sec. 4.02(h), 1959-1 Cum. Bull. 237, 242. Similarly, there was no evidence that Atapco's control of Crown justified a premium for Atapco's stock given the difficulties Crown was experiencing. (Pet. Br. below pp. 37-41.)

⁵ "Pet. Br. below" refers to the Petitioners' Brief in the Fourth Circuit Court of Appeals.

CONCLUSION

For the reasons stated in the petition and in this reply brief, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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